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SUBJECT: GOVERNMENT PARTIALLY DEREGULATES PETROLEUM
TRADE, HIKES SELLING PRICE

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SUMMARY

1. (SBU) On February 13, His Majesty's Government of Nepal (HMGN) announced an end to government control over retail pricing of petrol and diesel. After successive financial crises faced by the monopoly state-owned Nepal Oil Corporation (NOC) in 2005, a major move toward deregulation of the petroleum trade was increasingly necessary. The announcement, however, fell short of expectations for broader-gauged reform. The private sector cautiously welcomed the decision, but also urged gradual deregulation of imports. Compared to popular protest demonstrations against previous petroleum price increases, the recent wholesale price hike in kerosene and diesel generated little public reaction. Finance Minister Jyoti told a March 6 meeting of international donors the deregulation of oil prices was a major step in HMGN's effort to push through market-oriented reforms. With the new wholesale prices, NOC managed to break even in sales of a few imported petroleum products, but continued to incur an overall loss. NOC's cumulative loss to date amounts to USD 170 million. End Summary.

HMGN PARTIALLY DEREGULATES PETROLEUM TRADE

2. (SBU) In a major decision on February 13, HMGN removed government control over retail pricing of two highly consumed petroleum products, petrol and diesel. However, the monopoly oil importer NOC still remains the sole importer of all petroleum products. After NOC sank into a financial crisis caused by HMGN-regulated subsidized pricing of petroleum products, in November 2005 HMGN started developing draft legislation to end NOC's monopoly in the petroleum trade. The draft act was expected to deregulate both imports and sales of petroleum products and introduce a market-based pricing mechanism. The recent policy decision brought only a partial deregulation of the petroleum trade. Under the decision, NOC will now fix the ex-depot (wholesale) price for petrol and diesel, and retailers are free to fix the retail price. Bimal Wagle, Joint Secretary of the Ministry of Finance, told EmbOff that HMGN considered this decision as the first step toward full-scale liberalization of the petroleum trade.

NEED FURTHER DEREGULATION

¶3. (SBU) Finance Minister Roop Jyoti claimed to a formal gathering of international donors on March 6 that the deregulation of petroleum prices was one of a series of significant steps HMGN is taking to move the Nepali economy in a free market direction. He described the NOC as "a great milking cow" for the country's politicians. Under their rule the NOC had "bloated" from what should have remained a total of about 50 employees to almost ¶700. HMGN, Joyshi asserted, had "finally addressed this situation." Noting that some of the donors present had merely suggested that petroleum prices be adjusted more frequently to keep pace with costs, Jyoti boasted, "We've dismantled the whole NOC pricing mechanism" and that this had "removed a huge burden from the national treasury." The Minister added that "the people had accepted" the attendant price increases because, unlike past price hikes, they sensed that the government was not manipulating prices.

¶4. (U) Shiva Prasad Ghimire, President of the Nepal Petroleum Dealers' Association (NPDA), told EmbOff that the NPDA cautiously welcomed the government's decision to deregulate retail prices of petrol and diesel, but would also like to see the government take positive steps toward petroleum import deregulation. Ghimire added that deregulating retail prices had allowed competition, and as a result, consumers would benefit. Prachanda Man Shrestha, Joint Secretary of the Ministry of Industry, Commerce and Supplies, told EmbOff that HMGN needed to remove its control over wholesale pricing if the NOC was to be protected from incurring huge losses, and for the private sector to become firmly established in the petroleum trade.

NOC RAISED WHOLESALE PRICE OF PETROLEUM PRODUCTS

¶5. (SBU) Through an announcement on February 17, NOC revised the ex-depot (wholesale) price of petroleum products. NOC increased the price of kerosene by 22 percent, diesel by 15 percent and aviation fuel by 4 percent. Prices of petrol and cooking gas remained unchanged. Even though the price of petrol is higher than the NOC's buying price, NOC continued to lose roughly USD 3.0 million per month on the sale of cooking gas. Suresh Kumar Agarwal, Marketing Director of NOC, told EmbOff that the new wholesale prices of kerosene, diesel and aviation fuel were raised to the break-even level. Agarwal added that NOC had already incurred a cumulative loss of USD 140 to 170 million due to the delay by HMGN in making this decision, and the loss could not be recovered. According to media reports, NOC currently owes around USD 63 million to commercial banks and USD 56 million to the Indian Oil Corporation (IOC), and has used USD 50 million of its own savings to cover the differences in its buying and selling prices.

COMMENT

¶6. (SBU) HMGN's decision to deregulate the price of petroleum products, risking a political backlash, was a positive move. Finance Minister Jyoti is justified in claiming credit for it as such. The government's action, however, fell short of the complete deregulation some observers had hoped for. Though critics had argued that deregulation would lead to public protest, in reality, there was little if any furor over the government's move. This is due in part to the increased awareness that Nepal's prices of petroleum products are affected by international prices. The media did an excellent job educating Nepalis about the need to bring Nepal's prices in line with international prices. Despite common fear that privatization of the petroleum trade would promote cartel formation, the market has reacted positively after the recent deregulation of retail prices of kerosene and

diesel. HMGN should now quickly work to remove the subsidy on cooking gas, and gradually deregulate imports to ensure fair competition between NOC and private dealers. Promoting Foreign Direct Investment (FDI) as a means of upgrading Nepal's ancient petroleum distribution system would be a major leap forward.

MORIARTY